



The 11th Hour Files¹

Simply Unemployment

Definition and measure

- An individual is unemployed if she is actively searching for a job but is unable to find one
- The unemployment rate is the number of unemployed expressed as a proportion of the labor force $\rightarrow Urate = \frac{\text{number of unemployed}}{\text{labor force}} \times 100$
- The labor force is the *sum* of the employed and the unemployed
- Note that P3 questions may have 'noise' \rightarrow additional irrelevant numerical information \rightarrow ignore!

Problems of measurement

Official statistic

- ...is just an average; it thus provides no information about variations between regions of a country, between genders, age groups or ethnic background; it also reveals nothing about the duration of unemployment

Official statistic may *underestimate* true unemployment as a result of:

- Discouraged workers: individuals searching without any luck for a long time may drop out of the labor market

¹ Many thanks to my good friend and colleague Michael M. for this far better idea for a series title...☺

- Individuals settling for a part-time job who would have preferred a full-time job
 - The above cases are referred to as '*hidden unemployment*'

Official statistic may *overestimate* true unemployment because:

- During recovery some may claim to be unemployed despite having landed a job to continue to collect benefits
- Some individuals have jobs that cannot be reported e.g., drug dealing, prostitution, gambling etc.

Consequences of Unemployment

Economic consequences

- Lost output (GDP) forever
- Lower direct and indirect tax revenues
- Higher government spending as a result of unemployment benefits
- Lost income for the unemployed
- If prolonged, the stock of human capital of the economy shrinks, adversely affecting long term growth; poverty, both absolute and relative, increase
- Income inequality increases

Private consequences

- Lost income and lower living standards for the unemployed
- Skill erosion
- Probability of being hired decreases as employers often see the unemployed as 'damaged goods'
- Increased indebtedness
- Loss of self-esteem; higher stress; health problems; suicide

- Likelihood of family breakdown rises

Social consequences

- Rise in crime
- Rise in alcohol and drug abuse
- Social fabric erosion

Types of unemployment and policies to address each

Seasonal

- A result of seasonal variations of demand: nothing can be done or is done

Frictional

- Individuals in between jobs: unavoidable as people move and constantly search for better employment; can be decreased by better and faster job market info

Structural

- A result of a mismatch between skills of the unemployed and skills in demand in the labor market; why? (a) because the structure of an economy constantly changes as technology changes (b) because firms move and because comparative advantage may be lost to other countries (c) because of labor market rigidities including high minimum wages, powerful labor unions etc. Training and retraining opportunities as well as reforms that increase labor market flexibility are considered typical solutions

Cyclical or demand-deficient

- A result of recession; expansionary fiscal and easy monetary policies are used

(HL only) Natural (or, normal) Unemployment

- The unavoidable unemployment that exists when the economy is at its potential level of real output (also, equilibrium unemployment)
- Mostly frictional and structural